

TALENT MANAGEMENT: Myth or Reality in Today's SMEs?

A study into the importance and use of talent management within small and medium-sized enterprises

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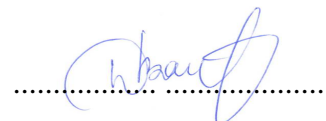
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Signed: Daiva Baublyte



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Table of Contents

Acknowledgements	ii
Visual aids	v
Executive Summary.....	vi
Explanations of terms and abbreviations.....	ix
1. Introduction	1
2. Methodology	4
3. Limitations	5
4. Theoretical Background	6
3.1 Definition: SMEs	6
3.2 Definition: Talent.....	7
3.3 Definition and theoretical background: Talent management.....	7
5. Purpose of talent management	13
6. Key issues in talent management	16
5.1 Formal vs. informal talent management	16
5.2 Human Resource-Based theory of SMEs	20
5.3 Integrated talent management.....	22
5.4 Employee Value Proposition	23
5.5 Management experience	24
5.6 Trust in employees.....	27
5.7 Talent management as an expense.....	28
5.8 Leadership style	29
5.9 Summary of the key issues	30
7. Effect of talent management on SMEs.....	32
8. Conclusion.....	34
9. Recommendations	37

10.	Bibliography and References	39
11.	Appendices	I
11.1	Appendix 1: Summary of de Kok, J. (2003) “Human Resource Management within Small and Medium-Sized Enterprises”	I
11.2	Appendix 2: Summary of De Kok, J. & Koch, C. (1999) “A Human-Resource-Based Theory of the Small Firm”	III
11.3	Appendix 3: Summary of De Kok, J. & den Hertog, D. (2006) “Is Human Resource Management Profitable for Small Firms?”	V

Visual aids

Tables:

Table 1 Categorisation of micro, small and medium-sized enterprises.....	6
Table 2 Differences in operationalization of HRM according to talent management perspective	11
Table 3 Talent management as a company grows	19
Table 4 Top five reasons that employees join a firm	25
Table 5 Top five reasons that employees would leave a firm	26

Figures:

Figure 1 Elements of Talent Management	8
Figure 2 Human capital management continuum.....	10
Figure 3 Workforce planning in multinational and financially high-performing companies	17
Figure 4 Human resource-based theory of the firm.....	20

Executive Summary

This individual research paper is exploring the use of talent management in small and medium size enterprises (SMEs), the goal being to identify whether it is widely practiced and how important it is for the business. SMEs constitute the largest part of markets and thus are very important for countries' economic performance. Unfortunately, there is not a lot of research done into the use of talent management or human resource management in SMEs. In the current knowledge-based economy it is hard to attract and retain top performers (especially for SMEs). Therefore, focus on talent management can help to win the "war for talent".

Three hypotheses have been raised:

1. *The smaller the company, the less evolved its HRM (and talent management) procedures are*
2. *SMEs do not need formalised talent management procedures due to higher degree of flexibility required within their business*
3. *SMEs focusing on talent management benefit their bottom line*

In the theoretical background chapter talent management is explained and important definitions are presented. The definition of talent management used in this research is: *talent management is the additional management processes and opportunities that are made available to people in the organisation who are considered to be 'talent'.*

In order to answer the hypotheses raised, key issues were identified and analysed with the help of secondary research. It was found that SMEs do identify the value and importance of managing their talent, especially within today's economic environment, but it is often

done informally. However, the bigger the company, the more formal their HR procedures tend to be (medium sized companies might have an HR department or manager, whereas most of micro and small companies do not). The HR strategies are more emergent rather than deliberate due to higher level uncertainty experienced in the market environment as compared to large scale enterprises (LSEs). It is clear that the owner of the company plays a much bigger role in forming HRM strategies and they are greatly influenced by different individual factors, such as management and HRM knowledge of the owner, attitudes towards employees and talent management, and leadership style.

In chapter 7 the profitability of talent management in SMEs is analysed. It was concluded that it has a positive effect on innovativeness, labour productivity and profitability in SMEs. Furthermore, it helps managers to create sustainable competitive advantage and plan, motivate, and retain their talent pool.

Finally, this research deduces that talent management is a reality within small and medium-sized enterprises, even though it is done more informally than in large scale enterprises. The first and second hypotheses are found to be connected and both were partly supported by the research. Companies do tend to be more informal while they are small (up to 50 employees), however, medium enterprises show a shift towards formal talent management procedures. Therefore, depending on the size of the company, formal talent management procedures are not always required. This can be linked to increased difficulty to manage a larger talent pool and different levels of uncertainty within the market environment experienced by companies of varied sizes. The third hypothesis is fully supported and the benefits of using talent management in SMEs are proved.

The last chapter is recommending SMEs to adopt talent management procedures. Managers are suggested to take management and HRM training in order to realise the

benefits of talent management. In addition, large enterprises are encouraged to take an example from SMEs in developing closer relationships with employees and simulate their work environment, i.e. “think global, but act local”.

Explanations of terms and abbreviations

Abbreviations:

HRD – Human resource development

HRM – Human resource management

LSE – Large scale enterprise

SME – Small-medium size enterprise (up to 250 employees) (see ‘Definition: SMEs’ below)

Explanation of terms:

Bottom line - The figure that reflects the company profitability on the income statement.

The bottom line is the profit after all expenses and taxes have been paid.¹

High performance work practices (HPWP) – a set of distinct but interrelated HRM practices that together “select, develop, retain, and motivate a workforce

- that possesses superior abilities
- that applies their abilities in their work-related activities
- whose work-related activities (i.e., actual employee behaviours/output) result in these firms achieving superior intermediate indicators of firm performance (i.e.,

¹ ViewPoint Bank (n.d.) “*Glossary of Terms*”, last accessed 21.05.2010
<http://viewpointbank.mediaroom.com/index.php?s=glossary>

those indicators over which the workforce has direct control) and sustainable competitive advantage²

Pivotal talent – an employee that is in a crucially important role within the business

Resource-based theory of firm or Resource-based view (RBV) - The core of the resource-based theory of the firm lies in a fundamental heterogeneity in the production processes of firms. Given certain inputs, each firm will apply these inputs in a different way, resulting in different outputs or products. As a consequence, sustained competitive advantage will result for those firms whose production process proves to be most efficient and whose outputs best meet demand. Inputs are usually divided in three categories: physical resources, organisational resources and human resources.³

Talent – see ‘Definition: Talent’ below

Talent management – see ‘Definition and theoretical background: Talent management’ below

² De Kok, J. & den Hertog, D. (2006) “*Is Human Resource Management Profitable for Small Firms?*”, SCALES (Scientific Analysis of Entrepreneurship and SMEs), Zoetermeer: p.13

³ De Kok, J. & Koch, C. (1999) “*A Human-Resource-Based Theory of the Small Firm*”, EIM Small Business Research and Consultancy, Zoetermeer: p.13

1. Introduction

During the economic crisis companies have made efforts to maximise their profits and minimise costs. One of the main factors that helped “weather the storm” was fostering labour productivity. Companies that have invested in their human resources to improve employee morale and productivity performed better than others during the difficult times (according to Watson & Wyatt research on the member companies in the MSCI Pan Euro Index).⁴ Special emphasis is put on attracting and retaining the best people in the company and focusing on their strengths to maximise efficiency. Therefore, talent management is becoming increasingly important. It is defined as “the additional management processes and opportunities that are made available to people in the organisation who are considered to be ‘talent’.”⁵

Talent management is important not only because of the difficult economic times, but also due to the aging population. Since there are more people retiring than entering the workforce, the talent pool is shrinking forcing companies to compete for the key people in the organisation. According to the research done by the Chartered Management Institute and Ashridge Consulting,⁶ retaining and developing top talent will become a critical success factor in the next five years, however, still over half of line managers are resistant to talent management processes. Reasons for this are highly differentiated ranging from lack of resources to managerial experience and knowledge. This research will aim to identify and analyse these issues in small-medium sized company concept.

⁴ Bensal, A. & Mendiratta, E. (2009) “*Crisis in Europe: approaches that helped weather the storm*”, Watson & Wyatt Directions: p.7

⁵ Blass, E. (2007) “*Talent management: Maximising Talent for Business Performance*”, Chartered Management Institute and Ashridge Consulting: p.3

⁶ Blass, E. (2007)

Most of the research done on talent management and its use is based on big international companies. Most of the recent publications and research studies emphasize the fact that talent management is very important in current economy, but they do not analyse its use and benefits for smaller companies. This is unfortunate, since the biggest part of any market consists of small and medium size enterprises (SMEs). It is evident that they cannot compete with large companies by offering a lot of formal training or high salaries, but they could utilize talent management to attract and retain their top performers.

This research paper will explore the use of talent management in SMEs and answer the following questions:

- How much are SMEs focusing on talent management?
- Does talent management bring any substantial benefits for SMEs?

There are few hypotheses that will be investigated. The first one analyses the link between company size and HRM practices. It is assumed that since SMEs are much less complicated and smaller in size, their HRM practices are weak or non-existent. In comparison, large organisations, due to their size and complexity, have to have a well-established HRM department and integrated talent management practices. Therefore, the first hypothesis is *the smaller the company, the less evolved its HRM (and talent management) procedures are*.

The second hypothesis analyses the benefits of talent management for SMEs. There are two different thoughts on this matter. The first one states that in SMEs there is a possibility for managers to monitor their staff more closely and develop individual bonds. Also, due to higher degree of uncertainty SMEs are experiencing within markets, more flexible and ad-hoc procedures are required. Therefore, highly standardised talent management is not

needed. In contrast to this, it is arguable that managers of SMEs are not aware of the benefits that talent management brings, nor do they have enough resources or knowledge to implement it. Thus, the second hypothesis is that *SMEs do not need formalised talent management procedures due to higher degree of flexibility required within their business.*

Third hypothesis will analyse whether talent management is beneficial to SMEs. It is important to know whether talent management brings substantial benefits, otherwise managers will be reluctant to use it. It is assumed that high performance work practices can bring high rewards to the bottom line of any type of business. Therefore, the third hypothesis states that *SMEs focusing on talent management benefit their bottom line.*

This research paper will give the reader theoretical background knowledge about talent management and evaluate why it is an important survival tool for companies in current knowledge-based market environment. Furthermore, the paper will explore existing current issues with talent management and HRM that small companies face and, with the help of secondary research, identify whether the hypotheses raised were correct or not. Finally, some recommendations will be made for both SMEs and large enterprises on talent management.

2. Methodology

The research is based on secondary data gathered from trustworthy research papers, publications and articles. Due to the fact that not a lot of theoretical concepts have been developed for talent management in SMEs, there is a lack of books on this subject. Therefore, one book by M. Armstrong⁷ was taken as a basis for building the theoretical knowledge, which was then developed with the help of information from other sources.

Publications from companies (such as Towers Watson,⁸ a.k.a Watson & Wyatt) focusing on research and development of Human Resource Management have been a great source of information about the use and benefits of talent management for both SMEs and large enterprises. Their white papers, research reports and various articles gave a lot of insight into the management – employee relationship.

Scholarly studies have been an important source of information. Particularly important sources are PhD research papers done by J. de Kok et.al. They were one of the most important publications for this research and thus their summaries are attached as appendices. Additionally lot of valuable empirical support has been provided by Emerald Group Publishing Limited's Education + Training journals and Journal of Small Business and Enterprise Development.

⁷ Armstrong, M. (2006) "A Handbook of Human Resource Management Practice", London: Kogan Page Limited

⁸ For more information about the company see <http://www.towerswatson.com/>

3. Limitations

“The lack of information about human resources in SMEs is problematic for theory, research and practice.”⁹ Therefore, a lot more research needs to be done to develop solid HR and management theories for proper understanding of talent management within SMEs. This research was focusing on secondary research due to time and resource constraints. Unfortunately, it was not feasible to carry out extensive and relevant primary research to provide empirical evidence to the conclusion and recommendations. Due to high degree of variety in HR practices within SMEs, a small sample size would not have given substantial results when evaluating the use of talent management. Therefore, it was more reliable to use secondary data carried out on hundreds of SMEs. (For summary and methodology of the research papers used to support this paper look at appendices.)

⁹ de Kok, J. (2003) “*Human Resource Management within Small and Medium-Sized Enterprises*”, Doctorate (PhD) Thesis, Erasmus University Rotterdam,

4. Theoretical Background

For the purpose of this research and general understanding of the topic it is important to define what talent, small-medium sized enterprise (SME), and talent management is.

3.1 Definition: SMEs

SMEs are considered as companies which employ up to 250 people and can be domestic and international. According to the European Commission definition “the category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro.”¹⁰ For a quick reference and more detailed delineation between micro, small and medium sized enterprises see the table below.

Table 1 Categorisation of micro, small and medium-sized enterprises¹¹

Enterprise category	Headcount	Turnover	or	Balance sheet total
medium-sized	< 250	≤ € 50 million		≤ € 43 million
small	< 50	≤ € 10 million		≤ € 10 million
micro	< 10	≤ € 2 million		≤ € 2 million

¹⁰ European Commission (2005) “*The New SME Definition: User Guide and Model Declaration*”, Enterprise and Industry Publications: p.5

¹¹ European Commission (2005): p.14

3.2 Definition: Talent

Talent can be a very vague term and can be understood very differently by different people. For the purpose of this research, people considered as talent are the ones who show potential in the company; namely the leadership, top performers, employees with leadership potential, and employees in “pivotal roles” (i.e. critical for the business).¹²

3.3 Definition and theoretical background: Talent management

Michael Armstrong characterises talent management as the “war for talent”. However, he argues that this definition downplays the role of the talent which is already within the company.¹³ The following elements are identified within talent management: attraction, retention, motivation and engagement, development, and succession planning. The main aim is to “develop and maintain a talent pool consisting of a skilled, engaged and committed workforce.”¹⁴ Figure 1 shows the elements and processes of talent management within companies. It is important to recognise that resourcing strategy stems from business strategy and thus is planned and formalised. It shows clearly how talent management is involved within human resource strategy and the role it plays within it. This figure is based on large companies, but SMEs do not always work in this manner. This research will analyse the approach that SMEs take to human resources and talent management.

¹² Pulse Survey Report (2009) “*Managing Talent in Tough Times*”, Towers Watson (originally published by Towers Perrin): pp. 4-5

¹³ Armstrong, M. (2006): p.389

¹⁴ Armstrong, M. (2006): p.390

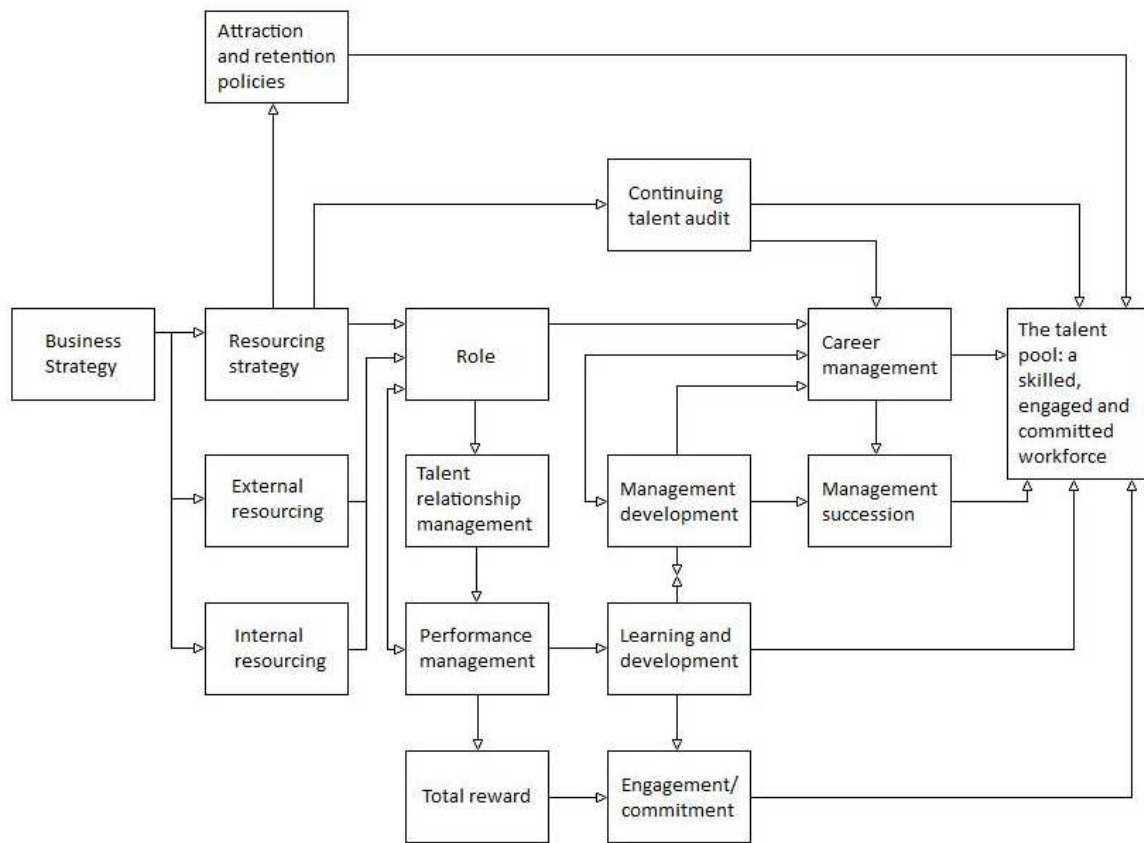


Figure 1 Elements of Talent Management¹⁵

On the other hand, Human Capital Institute states that talent management is a “set of tools and technologies that help organizations make good decisions about talent.”¹⁶ According to D. Creelman, it is not to be seen as a set of topics, but as a perspective or a mindset. In order for talent management to work, it has to become the top concern for managers and become second nature within the company (i.e. the goal is to achieve integrated talent management). Only through integrated talent management practices will a company realise its full benefits. This means that within the company talent management has to have connections both to business needs and corporate strategy, and must be spread across key

¹⁵ Armstrong, M. (2006): p.391

¹⁶ Creelman, D. (2004) “*Talent management: The Special Challenges of Small and Medium-Sized Enterprises*”, Human Capital Institute: p.3

processes (as seen in figure 1 above). Figure 2 outlines this point and summarises the idea behind talent management (as perceived by the Human Capital Institute). It indicates that talent management is a process requiring continuous improvement and involving all the procedures within the company. It is driven by company's vision, culture, mission, guiding principles, and strategy, which leads to formulation of human capital performance drivers. These drivers are divided into two main categories – acquisition and retention, which are the core of human resource activities. If carried out effectively, these drivers will result in committed and talented workforce, which will bring the company to “the next level” (as seen from human capital results in the figure below).

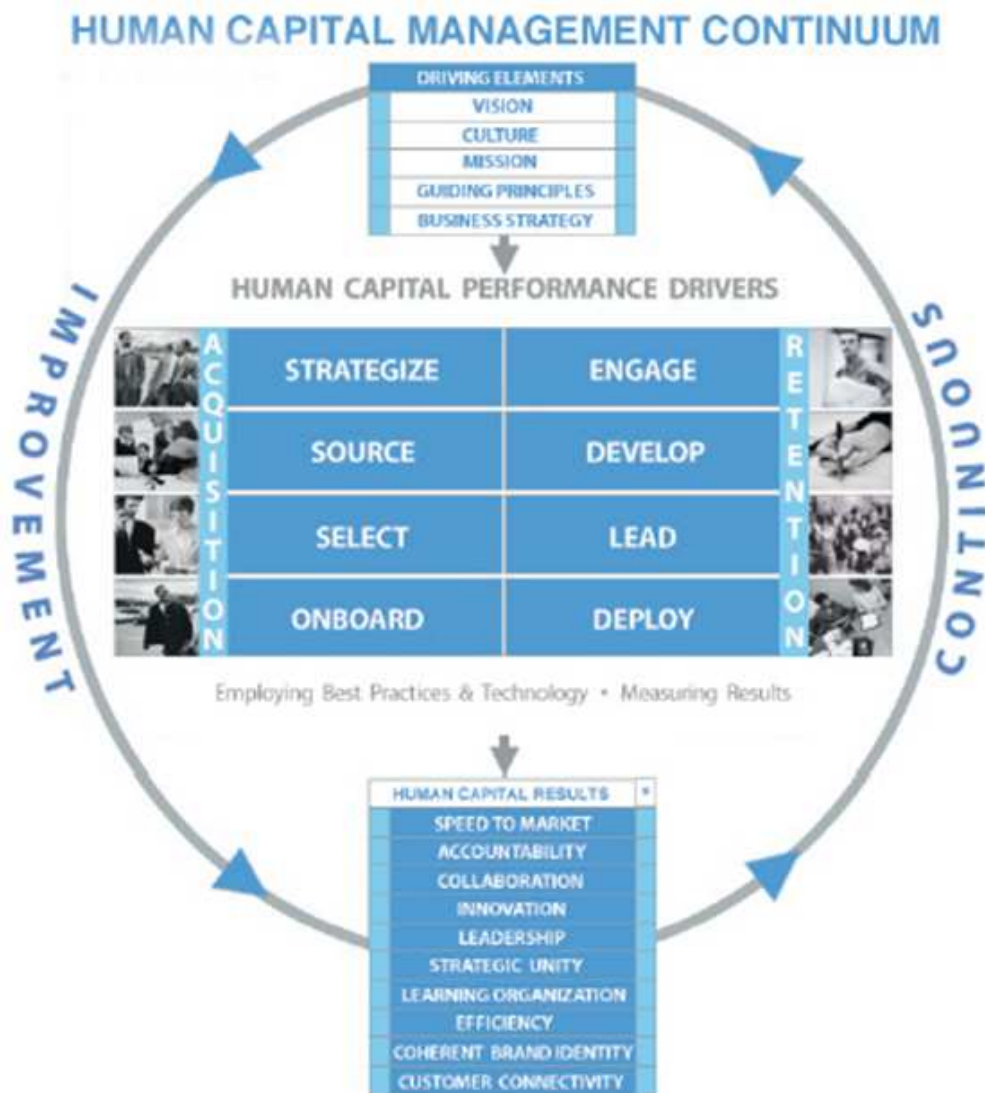


Figure 2 Human capital management continuum¹⁷

The definition of talent management, which will be used in this research, is developed by Eddie Blass from the Chartered Management Institute.

*“Talent management is the additional management processes and opportunities that are made available to people in the organisation who are considered to be ‘talent’.”*¹⁸

¹⁷ Creelman, D. (2004): p.6

¹⁸ Blass, E. (2007): p.3

This definition clearly states that talent is nurtured within the company. According to it, the people who are identified as “talent” are the ones who show potential (see Definitions: Talent above). According to table 2 below, the strategic perspective that the company has towards talent management defines how it is viewed, implemented, and put into operation. This also shows that talent management affects different processes of the company depending on the corporate strategy.

Table 2 Differences in operationalization of HRM according to talent management perspective¹⁹

Perspective	Core belief	Recruitment & Selection	Retention	Succession Planning	Development Approach
Process	Include all processes to optimise people.	Competence based, consistent approach.	Good on processes such as work-life balance & intrinsic factors that make people feel they belong.	Routine review process based on performance review cycle.	PDPs and development reviews as part of performance management. Maybe some individual interventions.
Cultural	Belief that talent is needed for success.	Look for raw talent. Allow introductions from in-house.	Allow people the freedom to demonstrate their talent, and to succeed and fail.	Develop in-house if possible, if not look outside.	Individuals negotiate their own development paths. Coaching & mentoring are standard.
Competitive	Keep talent away from the competition.	Pay the best so you attract the best. Poach the best from the competition.	Good people like to work with good people. Aim to be employer of choice.	Geared towards retention – letting people know what their target jobs are.	Both planned and opportunistic approaches adopted. Mentors used to build loyalty.
Developmental	Accelerate the development of high potentials.	Ideally only recruit at entry point and then develop.	Clear development paths and schemes to lock high potentials into career paths.	Identified groups will be developed for each level of the organisation.	Both planned and opportunistic.
HR Planning	Right people in the right jobs at the right time.	Target areas of shortage across the company. Numbers and quotas approach.	Turnover expected, monitored and accounted for in plans.	Detailed in-house mappings for individuals.	Planned in cycles according to business needs.
Change Management	Use talent management to instigate change in the organisation.	Seek out mavericks and change agents to join the organisation.	Projects and assignments keep change agents, but turnover of mainstay staff can occur.	Can be a bit opportunistic initially until change is embedded.	Change agents develop others who align with them and become the next generation of talent.

Small companies are not as likely as large enterprises to adopt competitive, developmental, HR planning and change management approaches due to their size and limited resources

¹⁹ Blass, E. (2007): p.3-5

(however, it is still possible that they do). Competitive approach involves having the most attractive salary and benefits package, which small companies cannot always offer. Developmental model involves a lot of investment in training and a lot of commitment towards the employee. As will be discussed later, SMEs often see training as an expense rather than investment. HR planning approach can be associated with the presence of HR department and formalised HR procedures, which is not always found in SMEs. Finally, change management approach uses change agents to smooth the transition, whereas in SMEs due to their size it is easier to implement change and resistance is relatively smaller. Change agents can be managers/owners themselves. These issues will be developed more in length within the Key Issues section.

5. Purpose of talent management

“Talent is the one natural resource that organisations and even countries have – and it is the one resource that businesses and industries have to reinvent themselves to succeed in the new global economy.”²⁰

Talent management is becoming increasingly important in the new knowledge-based economies, where companies are fighting for highly trained employees within shortage of qualified labour supply. The majority of SMEs in Europe (60%)²¹ feel that the competition has increased in the recent years and therefore, developing sustainable competitive advantage becomes essential. One way to achieve this is through your human capital. Unfortunately, attraction and retention of highly qualified staff is much harder for SMEs. In the EU one third of SMEs are struggling to find suitable human resources. This is due to scarcity of skilled and un-skilled labour and factors associated with the job, such as low image of the job, enterprise or sector, unpleasant work or working conditions, and high wage expectancies.²² It is clear that SMEs have a need to focus and develop their current staff in order to be competitive in the current employment market.

The recent economic recession has changed the relationship between companies and their employees. Downsizing, pay cuts, recruitment freezes, removal of bonuses, etc. have made workers stressed and uneasy. Constant fear of losing your job has greatly affected commitment and motivation. People that survived the “cut” faced higher workload and stress levels with same or even smaller benefits. Out of these “survivors” it is safe to assume that most would be considered as talent. This raises a problem, since within

²⁰ Blackwell, J. (2010) “Where will your future talent come from”, Working Futures, Management-Issues Ltd.

²¹ European Commission (2007) “Observatory of European SMEs”, Flash EB Series #196 – Enterprise Observatory Survey, Gallup Organization Hungary: p.19

²² European Commission (2007): p.23

downturn economy these people are the ones that are sought after. Therefore, it is easiest for them to switch to a job with a better deal. This is where managers have to see the red light and start focusing on talent management.

Integrated talent management can help companies to cut costs, enhance productivity and reduce risks. It is an acknowledged fact that a motivated employee will perform better and be more committed to the company. Therefore, absenteeism, workforce turnover, and knowledge pool become more stable and easier to manage. High performers, high potentials and pivotal talent are a critical resource and one of the main sources of sustainable competitive advantage. Thus, companies (including SMEs) must be proactive about nurturing, supporting and making sure that their top talent knows they are important. Having a staff that the manager can trust and depend on is essential for business success.

Having a long-term talent management plan enables managers to predict recruitment, training, succession planning and retention needs more efficiently. Relying on ad hoc and need-based HRM practices has forced a lot of companies to downsize. This can lead to a lot of negative long term consequences, such as demotivation, re-staffing, uncertainty and mistrust in your workforce, etc. Companies focusing on the long term HRM strategies are investing in their bottom line for the future.

Not only does talent management help companies in tough times, but it will also help to move forward once economy is stable again. Recession has changed the business world and we are now on the brink of “talent wars”.²³ Once the job market becomes more attractive, many employees will start migrating between companies. Attractive offers will especially start flowing towards top talent. Having committed staff will help to retain critical employees within the company and will make transition to a better economy much

²³ Pulse Survey Report (2009)

easier. The key finding is the fact that in general companies practicing integrated approach to reward and talent management have not only achieved better attraction and retention results, but also stronger financial performance (25% and 18% less likely to have problems with attracting and retaining top performers (respectively), and 18% more likely to be high performing organisation).²⁴

Employer branding is much easier to do in big, well-known companies and this is why smaller companies have difficulties attracting and retaining top performers. Big companies are usually much older with a long experience of HRM practice and have established their name within the market. Publications such as “The Sunday Times Best 100 Companies to Work For” influence perceptions of labour market towards large companies. They can offer better working conditions, higher salaries and benefits, and job security. Unfortunately, SMEs cannot always offer that and thus attracting and retaining talent becomes very hard within SMEs.

²⁴ Hathaway, C. (2008) “*The power of integrated reward and talent management. 2008-2009 Global strategic rewards report and EMEA findings*”, Watson Wyatt Worldwide: p.2

6. Key issues in talent management

In this section the main issues associated with talent management in SMEs will be analysed and discussed. They were gathered through extensive secondary research. SMEs by nature are diverse and each company is very unique. Therefore, it cannot be said that topics discussed in this chapter are applicable to all or that these are the only issues. However, they could be said to be dominant in majority of companies or be the most influential.

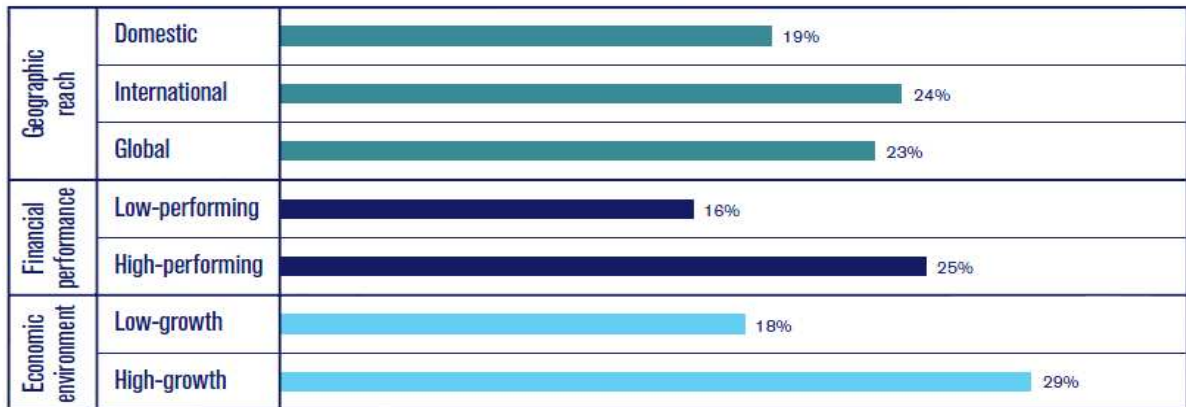
5.1 Formal vs. informal talent management

Micro (up to 10 people) and small companies (up to 50 people) prefer informal management and HRD procedures. Medium companies (up to 250 people) exhibit a transition towards formal systems and a mixture of formal and informal procedures is seen in many cases; whereas larger companies use complicated and formal procedures both in HRD and management.

Multinational and financially high-performing companies are more likely to conduct formal workforce planning (as seen in the figure 3). The fact that large companies are more focused on formal talent management is due to necessity. Large companies are harder to control and identifying talent within so many employees is much more difficult. Thus, formal measures have to take place since managers are not that close to their employees as in smaller companies. According to J. De Kok, “large firms are more likely to standardize their tasks, and formalization of HRM practices will allow them to be more

efficient in recruiting, selecting and maintaining employees with the right qualifications for given tasks and positions”.²⁵

Multinational and financially high-performing organisations in high-growth markets are more likely to conduct formal workforce planning



Financially high-performing firms report more workforce planning activities



Figure 3 Workforce planning in multinational and financially high-performing companies²⁶

According to David Devins and Steve Johnson, SMEs are focusing less on the formal talent management procedures. However, this does not mean that they do not exist. Research shows that “HRD practices in the small organisations are revealed as largely

²⁵ De Kok, J. (2003): p.71

²⁶ Hathaway, C. (2008): p.6

unplanned and reactive, accompanied by informal on the job training activity and led by someone other than a HRD officer or expert.”²⁷ The pre-regulated or structured HRM systems do not fit everyone and there is no need for them in smaller companies, since they can tailor towards each individual. In addition, knowledge and skill sharing between employees is playing a big role. This might be the result of a lack of formal training or simply due to closer relationships developed within the company. This is also argued by Clare Rigg and Kiran Trehan. According to them, “a significant source of HRD can be engagement of one or two influential individuals in formal learning that gets fed back into the company”.²⁸

Their research has identified that there is a clear relation between the use of HRM practices and the increase in formation of skills, but still HRD practices in small organisations are largely unplanned, accompanied by informal or on the job training activity and led by someone other than HRD officer or expert.²⁹ A lot of employers are focused on just-in-time training and recruitment without a proper HRD strategy or HRM budgets, as shown in the table 3.

²⁷ Devins, D. & Johnson, S. (2002) “*Engaging SME managers and employees in training: lessons from an evaluation of the ESF Objective 4 Programme in Great Britain*”, Education + Training 44 (8/9), Emerald Group Publishing Limited: p.370

²⁸ Rigg, C. & Trehan, K. (2002) “*Do they or don’t they? A comparison of traditional and discourse perspectives of HRD in SMEs*”, Education + Training 44 (8/9), Emerald Group Publishing Limited: p.396

²⁹ Devins, D. & Johnson, S. (2002): p.374

Table 3 Talent management as a company grows³⁰

MILESTONE	ROLE OF HR	TALENT MANAGEMENT STYLE
<100 people	One personnel person handling administration, often someone promoted from the clerical ranks.	The style and skill of the CEO is of overwhelming importance. Talent management may be anywhere from superb to abysmal.
100-300	Professional HR generalist with one or two support staff.	<p>Systems for compensation, performance appraisal, recruitment, onboarding, and training are set up.</p> <p>Data tracked in spreadsheets or a database or possibly entry level HRIS.</p> <p>Focus is on compliance and creating some methods for managing talent that are consistently followed throughout the firm.</p> <p>Possible to create a strong culture that values talent—a culture that will drive the future success of the firm.</p>
300-1,000	<p>Professional HR department with specialists in some areas such as compensation, training and recruitment.</p> <p>VP HR may play a strategic role.</p>	<p>Specialist expertise in many talent-management functions is now available in-house and where it is not available (for example in organizational development), consultants may be used.</p> <p>A full-fledged HRIS will be in place supported by modules or stand-alone products for recruitment, compensation and training.</p> <p>Focus is on using talent management to increase competitive advantage.</p> <p>Even at the bottom end of this range, companies can have sophisticated talent-management processes in place.</p>
1,000-3,000	<p>HR department grows beyond a handful of staff to perhaps 20-30 people.</p> <p>VP's role is in managing the department and providing strategic direction.</p> <p>HR may now include business partner roles working in business units, centers of expertise and a call center.</p>	The challenge of scale means that there is a heavier reliance on technology and formal processes to manage talent.

This figure supports the theory that within small-medium size company concept the HR practices are less formalised and depend a lot on the owner or CEO of the company. However, medium sized companies already show a trend to adapt more formalised procedures and the value of talent management is recognised.

³⁰ Creelman, D. (2004): p.18

5.2 Human Resource-Based theory of SMEs

Jan de Kok's research on human resources in SMEs proves that size is related to the formalization of HRM practices.³¹ It is clear that SMEs use less of formal high performance work practices (which include talent management). However, there are other factors affecting HRM in smaller companies. This can be identified applying the human resource-based theory of the firm.

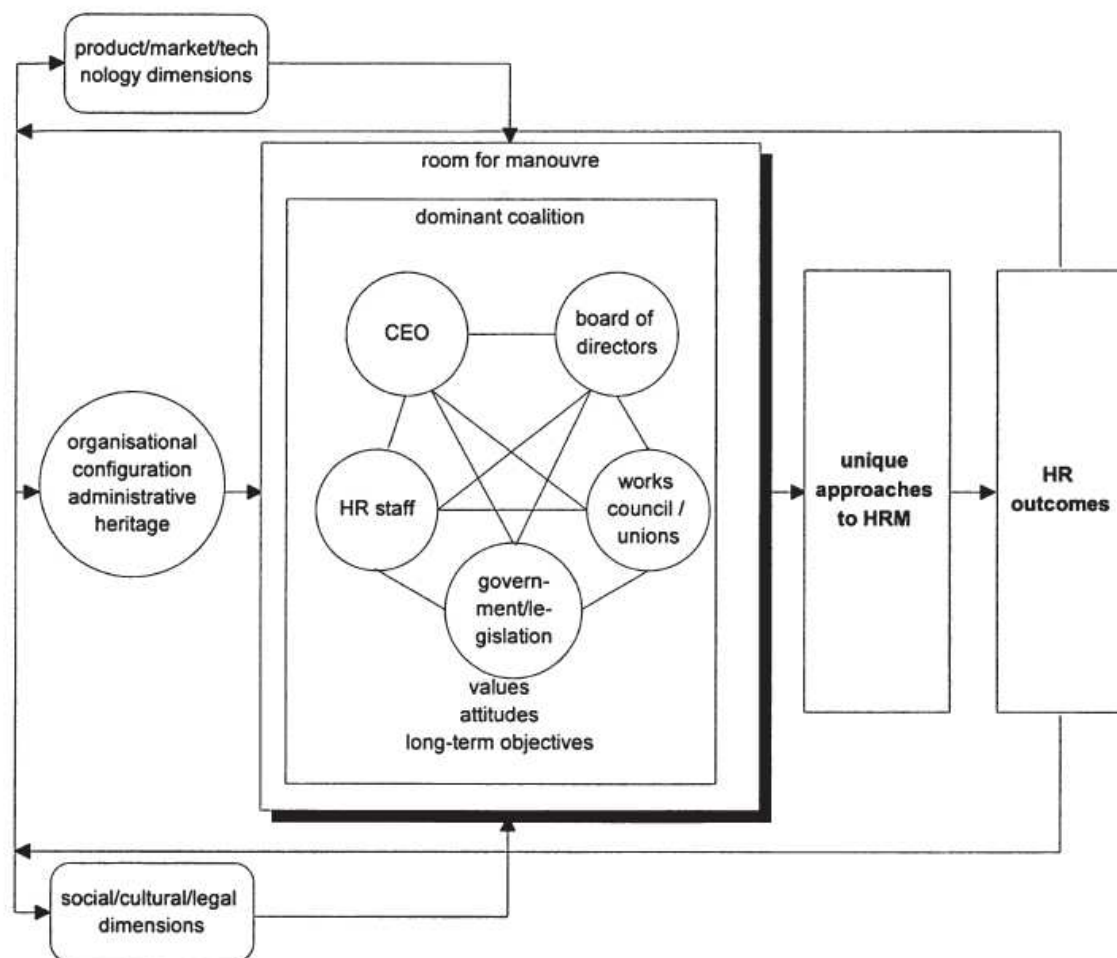


Figure 4 Human resource-based theory of the firm³²

Human resource-based theory identifies the main factors affecting the human resource strategy within the company. The main body directly influencing the HRM within the

³¹ De Kok, J. (2003)

³² De Kok, J. & Koch, C. (1999): p. 14

company is called the dominant coalition. Their values, attitudes and long-term objectives directly affect the quality of HRM. However, their room for manoeuvre is limited by three dimensions (product, market, technology dimension, organisational configuration and administrative heritage dimension, and social, cultural, legal dimension). An outcome of these aspects then is a unique approach to HRM which determines the real HR outcomes in the company.

Within small companies the dominant coalition is concentrated upon a smaller number of people. Therefore, from within the company the board of directors, the CEO and the HR staff are often one or very few people. Influence of works councils or unions has much less effect due to a small number of employees.

Therefore, the owner or manager of the company has relatively more power on HRM than a manager in a LSE. HRM in SMEs becomes increasingly dependent upon the values, attitudes and long-term objectives of the owner.

J. de Kok identified several factors influencing HRM based on this theory.³³ As already mentioned, company size has a direct effect on high performance work practices within the company. However other aspects can be just as important. Availability of a business plan indicates a long term orientation of the company meaning that human resource planning (together with talent management) becomes more important. Thus, having a talent management also focusing on the long term becomes a requirement. Family ownership affects the HPWP negatively, since it is associated with the loss of control and flexibility of employee relations. Family ownership usually implies the want to stay independent and keep full control over the business (this is also discussed later on in section 5.6). Presence of HRM department or manager has a positive impact towards HPWP. A professional

³³ De Kok, J. (2003)

working within HRM knows the benefits of high performance work practices and thus, will try to implement them (also see section 5.5). Besides, this already takes away the HRM decision making from the CEO spreading it through more people.

5.3 Integrated talent management

“A complete talent management strategy incorporates an organization’s values, its recruitment strategy, employee training and development, performance management, rewards and human capital metrics to actively support the business.”³⁴ The full benefits of talent management can only be achieved if they are fully integrated. Small companies which tend to have informal HRM usually do not have proper follow up after the training of their employees and thus, gains are diminished. Employees seek recognition and support for their work and, if there are no proper human resource development practices implemented, measuring the effect of training and performance of employees becomes very hard.

According to Pulse survey by Towers Watson (done mainly on large companies), only a quarter of organizations surveyed have more than partially integrate their talent management strategies. They identified that the most critical talent management processes for achieving results (and hardest to implement) are integrating talent management processes more directly into business strategy and operations, creating more consistency in how talent is identified, developed and moved throughout the organization, and giving business leaders greater ownership and accountability for building talent pipeline. In the light of this, it is clear that not only HR managers/department, but also the CEOs and managers of different departments have to be involved in developing talent management. This is quite hard to do for large companies and thus, they tend to focus on familiar

³⁴ Pulse Survey Report (2009): p.13

territory fearing to change their management habits and fully implement talent management. However, looking at smaller companies, where number of employees and authoritative figures is smaller, implementation of integrated talent management should go smoother and easier. Therefore, there is no reason why fairly small firms cannot have sophisticated talent management processes.

5.4 Employee Value Proposition

Most of Watson & Wyatt articles on talent management put a lot of emphasis on Employee Value Proposition (EVP), which is the “collective array of programmes the organisation offers in exchange for employment”.³⁵ It is influenced by organisation’s business, brands, values, culture, and leadership. It is much harder for smaller companies to compete with employment packages from larger companies. Salary and bonus packages, together with added benefits such as company car, make large companies so much more attractive as an employer. Also large companies are seen as more stable and progressive workplaces than small companies. Therefore, smaller companies must try to provide the full package of benefits and incentives that they can offer rather than salary alone in order to attract and retain top performers. They have an advantage of being able to cater to individual needs, which stimulates motivation and can be a selling point to the future employees. “Companies need all kinds of drivers, not just money. (...) Whether it’s time as currency, whether it’s new forms of recognition, whether it’s great ways of turbocharging your teams, it’s clear that top talent today responds best to a wide and generous set of human motivators.”³⁶

³⁵ Hathaway, C. (2008): p.4

³⁶ Dearlove & Crainer (2009) “*Keeping top talent in a down economy*”, Management Members, Management-Issues Ltd.

However, the proposed EVP has to match the truth. If employee gets a better impression of the company and the job than it actually is, he or she will get demotivated much faster and will be more likely to switch the job. Therefore, small companies and their managers have to be extremely careful when portraying their EVP. Finding and hiring top talent can be very costly and thus a company simply cannot afford to be careless. Retaining top performers is the biggest challenge.

Unfortunately, a lot of managers in SMEs do not recognise the advantages of having a well thought out EVP. Even job description is not used everywhere or utilised to its full potential.³⁷ This can be partly attributed to constantly changing nature of work and required skills. It is also hard to keep competency framework up to date all the time. Therefore, although job descriptions and competency frameworks help to map out desired behaviours and roles against which an employee can be evaluated, thus aiding the identification of training needs, they can also be seen as limiting, especially in SMEs. They reduce flexibility and control over employees, which in most cases is sought after in SMEs. Unfortunately, whilst managers are struggling to control these issues, employees see job descriptions as nothing more than a type of contract, which does not add any real value.³⁸ This proves that in the hands of an inexperienced manager talent management practices can become a problem.

5.5 Management experience

Employees are more likely to leave managers rather than companies. In SMEs, where owner has most control over the business having at least some management experience is significant. Having HRM knowledge or an HR expert within the company makes it easier

³⁷ Keogh, W. & Stewart, V. (2001) "*Identifying the skill requirements of the workforce in SMEs: Findings from a European Social Fund project*", Journal of Small Business and Enterprise Development 8 (2), Emerald Group Publishing Limited

³⁸ Keogh, W. & Stewart, V. (2001)

not only to attract and manage employees, but also to retain them. As already mentioned above, HR manager will know the advantages of talent management and help your company to establish sustainable competitive advantage.

It is important to recognise that there is a difference in perceptions between managers and employees of what are the most important things in working environment. This is where SMEs have an advantage due to the ability to develop closer relationship between the employee and the manager. Watson & Wyatt has identified that employees (both of SMEs and large enterprises) see employer reputation, base pay and career development opportunities as the most important characteristics in attracting employees to a job. On the other hand employers think that most important is base pay, job security and the nature of work (as seen in figure below).

Table 4 Top five reasons that employees join a firm³⁹

Company view		Employee view	
All employees	Critical skill employees	All employees	Top performers
Employer reputation	Career development opportunities	Base pay	Job security
Base pay	Employer reputation	Job security	Base pay
Career development opportunities	Organisation culture	Nature of work	Nature of work
Organisation culture	Base pay	Work/life balance	Career development opportunity
Job security	Nature of work	Career development opportunity	Work/life balance

Also there is a difference between perceptions of why employees leave companies. According to employees the main reasons are base pay, stress and career development opportunities, whereas employers think that base pay, career development and promotion opportunities are most important.

³⁹ Hathaway, C. (2008): p.22

Table 5 Top five reasons that employees would leave a firm⁴⁰

Company view		Employee view	
All employees	Critical skill employees	All employees	Top performers
Base pay	Career development opportunities	Base pay	Base pay
Career development opportunities	Promotion opportunity	Stress levels	Stress levels
Promotion opportunity	Base pay	Career development opportunity	Promotion opportunity
Work/life balance	Relationship with supervisor/manager	Promotion opportunity	Incentive pay opportunity
Relationship with supervisor/manager	Work/life balance	Incentive pay opportunity	Career development opportunity

This is very important information to know for talent management, since then managers are aware of areas to focus on for attraction and retention of employees. As already mentioned earlier, attraction and retention of qualified employees are especially hard for SMEs. Therefore, developing an EVP based on these findings will already force companies to implement some sort of talent management techniques.

SMEs have one clear advantage over larger companies when attracting and retaining employees. Due to special characteristics of their working environment and the ability to interact closely with employees, it is easier to portray company values and culture. There is a sense of being “special” when working for a small company, which can also be associated with entrepreneurship and niche markets that companies are working in (i.e. they are highly specialised and unique).

Management experience is important not only to recognise the motivators or demotivators of employees, but also to identify their potential. Talent management focuses on people with high potential. Unfortunately, not all managers have enough knowledge of HRM to recognise and monitor the progress of their employees. Whilst being a micro or small company, it is easier to recognise the potential of employees due to closer working

⁴⁰ Hathaway, C. (2008): p.23

conditions. Performance appraisals can then be carried out in an informal manner and employees can identify and suggest themselves what they need to develop. But once a company reaches a certain limit where manager cannot keep track of employees closely anymore, there is a need to formalise HR procedures in order to be able to recognise talent. Therefore, if there is an absence of HR department, manager or formalised HR procedures, there are bound to be unrecognised talent within the company. It is up to the manager's knowledge, experience and attitude towards their staff on whether talent management will be effective or not.

5.6 Trust in employees

In all companies there is a problem of trust in employees. Will investment in an employee pay off? Is the employee committed enough to the company? SMEs can be particularly sensitive to this, since managers of the company are often the owners. Therefore, decentralising and relinquishing power to someone else can be particularly tough due to high personal involvement with success of the business. If the manager does not trust anyone else to do the job as well as he or she does, then they will be slow in developing proper training and succession planning practices. This is especially a big issue in family owned businesses. Mostly only family members get enough training and are viewed as long term committed and trustworthy employees. This is a problem since other employees can feel unappreciated and without a future in the company. As seen in tables 4 and 5, career development opportunity is one of the main reasons for employees to join and leave a company. Results of the Pulse Survey (done by Towers Perrin)⁴¹ show that career advancement is a key driver of engagement, which in itself has a direct impact on how employees perform and contribute to bottom-line results. Yet, these are all areas that the

⁴¹ Pulse Survey Report (2009)

survey respondents identified as points of weakness in their current talent management practices.

However, nowadays due to tough economic situation, the trust problem rests not only with employees, but also with employers. According to the latest Global Workforce Study (done by Watson Towers),⁴² the recent economic downturn and the current climate of uncertainty have also created a longing for leaders who connect with their workforce. Employees do not feel that they are safe with their jobs and they are eager to sacrifice career growth for job security. Unfortunately, this does not mean that employees are committed or motivated within the company. Confidence in leadership and management is all-time low and, as mentioned earlier, employees tend to leave the management rather than the company. This type of environment makes it very hard to produce quality work and, if unmanaged, it can create big problems for companies. This is where well structured talent management procedures can save the situation. In order to retain critical personnel companies have to reassure them about their job security and raise morale. Employers need to create workforce that plans to stay for years, or even decades, and stop hunting for talent. Yes, it is important to attract the best people, but the most significant is what you do with the people inside your company. This way the dreaded “brain drain” can be avoided.⁴³

5.7 Talent management as an expense

Research article written by Harry Matlay focuses on family businesses and HRD strategies. It has identified a training paradox in small businesses: employers are positive towards training, but the actual provision rates are low. Reasons mentioned for this are:

⁴² Unknown author (2010) “*The Shape of the Emerging “Deal”: Insights from Towers Watson’s 2010 Global Workforce Study*”, Towers Watson

⁴³ Wraight, B. (2010) “*Recession Leaving a Trail of Insecure Employees in its Wake, According to New Study*”, Towers Watson

market positioning of a business, prevailing economic conditions, availability of relevant training, time constraints, cost of training, lack of trainee cover and in-house trainers, and issues related to employee interest and motivation.⁴⁴ The managers view training as an expense, not an investment.⁴⁵ This is an issue in SMEs since they have limited financial resources. Large companies have faster returns on investment when implementing talent management. For example, they can standardise their training and spread it through a bigger workforce, whereas return for smaller companies takes longer. Also due to the fact that effects of HPWP are hard to measure, some managers can see it as an extra expense. Since developing your workforce is a source of competitive advantage, employees have to change this point of view and see talent management not as a resource consumption (both time, human capital and funds), but as an investment for the future. Managers with little HRM experience will not recognise this fact and therefore, if their attitude towards talent management is as an expense and they are focused on short term strategies or their values rest with profit, they will more likely avoid implementing it. This is happening especially in small and micro companies (up to 50 people). As already seen above, the values, attitudes and long or short term strategies of the owner of the company can greatly affect HR outcome in SMEs.

5.8 Leadership style

According to leadership theory Y and theory X developed by Douglas McGregor, managers adopt either hard management or soft management according to the way they view their staff.⁴⁶ If they see their employees as naturally lazy, disliking work,

⁴⁴ Metlay, H. (2002) *“Training and HRD strategies in family and non-family owned small businesses: a comparative approach”*, Education + Training 44 (8/9), Emerald Group Publishing Limited: p.359

⁴⁵ Metlay, H. (2002): p.364

⁴⁶ McGregor, D. (1960) *“Hard or soft management? Theory Y Theory X”*, Value Based Management.net, last accessed 21-05-2010

< http://www.valuebasedmanagement.net/methods_mcgregor_theory_X_Y.html>

responsibility and seeking direction, they are less likely to develop integrated talent management. On the other hand, if they see people as motivated to work and self directed, then it is expected that they will want to decentralise and develop their staff. Thus, naturally talent management must be present. As already mentioned earlier, management has to recognise that talent management is an investment into the future and a source of building sustainable competitive advantage, rather than a source of cost saving.

5.9 Summary of the key issues

In the light of the issues discussed above, it can be concluded that in general SMEs do identify the value and importance of managing their talent, especially within today's economic environment. It is done in a more informal way and on average smaller companies concentrate more on informal high performance work practices than larger companies do. Their strategies are more emergent rather than deliberate. This is due to the uncertainty of environment that they are working in. According to J. de Kok, "uncertainty regarding internal activities and procedures is lower for small-firm employers, because it is easier to directly monitor the activities of most or all employees. The external uncertainty is, however, higher for small firms. This is a direct result of their lack of power at various market places, for labour, capital, and output."⁴⁷ However, it is not safe to assume that all SMEs are less formal. Some can have very sophisticated HRM policies, and most of the research studies done on the subject were not anticipating that. Especially, once the threshold is passed towards the medium size enterprises, it is observed that their sophistication increases and there are HR departments or managers present.

On the other hand, due to the highly diverse environment that these companies are working in and their complexion, they are more influenced by the individual personalities of

⁴⁷ De Kok, J. (2003): p.14

business owners and managers. The dominant coalition usually rests with much fewer people than LSEs and the smaller the company, the greater power they have. Factors such as leadership style, trust in employees, management knowledge, attitudes towards talent management, etc. play an important role. Therefore, informal approach can be believed to be more suitable for small firms.

7. Effect of talent management on SMEs

When assessing whether talent management is myth or reality in SMEs it is important to look at whether it is profitable, since companies will not be using HR methods which are not bringing substantial benefits. J. de Kok and D. Den Hertog have made an investigation on whether high performance working systems affect innovativeness, labour productivity, and profitability in small Dutch companies.⁴⁸ The research was done by using interviews of managers of 909 enterprises of more than 5 employees (maximum size was 175 people). Information was gathered on performance indicators, HRM practices, leadership style of the entrepreneur and several characteristics of the enterprise and the entrepreneur. The findings prove that innovativeness, labour productivity, and profitability are positively affected by the presence of HPWS. This is because “HRM practices that firms have in place need to ensure that an environment exists where employee creativity can thrive and in which new knowledge and skills can be created as well as successfully implemented. Through creating an able and motivated workforce HPWS may help build the needed capacities for successful innovation that is so crucial to small firms”.⁴⁹ However, the research also identified that HPWS is more profitable for the large companies than small ones. Thus, profitability and HPWS are linked to the size of the company.

In addition, factors involved within talent management, such as employee value proposition, integration of HR functions and workforce development has positive influence towards recruitment, retention, and motivation of employees. It also makes it easier for the manager to identify key talent within the company and develop sustainable competitive advantage.

⁴⁸ De Kok, J. & den Hertog, D. (2006)

⁴⁹ De Kok, J. & den Hertog, D. (2006): p.37

Concluding from this research we can assume that talent management is important for any business and having an integrated approach towards it can positively affect the profitability and productivity within SMEs. However, managers have to be aware of the fact that focusing on certain aspects of talent management will not bring as much benefits as a whole system. A lot of companies are falsely thinking that they have talent management practices in place, but in reality they do not work, since it is done unevenly or not thoroughly, rendering it meaningless.

8. Conclusion

The hypotheses put forward in this individual research project were as follows:

H1: The smaller the company, the less evolved its HRM (and talent management) procedures are.

H2: SMEs do not need formalised talent management procedures due to higher degree of flexibility required within their business.

H3: SMEs focusing on talent management benefit their bottom line.

Through the secondary research carried out it can be concluded that the first hypothesis is partly supported. It is true that the smaller the company the less formalised their HRM is as compared to larger companies. They tend to focus more on informal practices and HRM knowledge is in general lower than in LSEs. However, there is a great variety between companies due to the fact that they are working within a highly volatile environment, and their HRM in most cases rests within the hands of several people in the dominant coalition. Therefore, the extent to which talent management is present varies according to each individual company.

It is also noticed that within SME sector, talent management (and HRM) implementation greatly depends upon the size of the company. Micro companies, of which majority are family owned businesses, display the need for high level of control and thus, HR decision making power is concentrated with the owner and is usually poorly developed. Moving towards small companies (10-50 people) we see the need to implement basic HRM functions. Control usually still rests with the owner, but there is an increasing recognition to develop attraction and retention procedures. Finally in medium-sized companies we can

already see the distinction between the owner and the HR department or manager. This in turn leads to greater knowledge of HRM and implementation of talent management.

The second theory is also partly supported. It is true that SMEs do not need formalised talent management procedures. However, it is important to acknowledge that with increased size, higher level of formalisation becomes a necessity in order to cope with management of increased amount of people. It is safe to assume that this hypothesis is linked to the first one. Due to high uncertainty within SME business environment managers have to be flexible and adaptive, and thus, it is easier for them to keep informal. Furthermore, talent management in SMEs is different than in larger firms. They face some constraints that are not an issue in larger firms, such as lack of specialized expertise, but have powerful advantages such as dealing with talent on a case-by-case basis. This can be viewed as an advantage compared to large companies, where formalised talent management procedures can result in inefficiency and unsuitability for employees (due to reduced flexibility). Proper support and follow up after such activities as training and recruitment is important in order to achieve full benefits. However, a lot of SMEs do not have the resources or knowledge to properly carry out talent management. Training, succession planning and retention are done ad hoc without proper follow up or sometimes not at all. Trust issues in employees are great, especially in family owned businesses.

The third hypothesis is fully supported. Talent management has a positive impact on profitability, labour productivity and innovativeness in SMEs. Furthermore, it helps managers to plan, motivate, and retain their talent pool. This in turn helps to create sustainable competitive advantage and progress within today's knowledge-based economy.

Altogether, it is concluded that talent management in SMEs is a reality, but it is presented in a different form than in large organisations. It can be very differentiated depending on

the type of business, the owner, his or her values and role in the HRM decision making process, etc. Commonly informal practices are the main focus; however, there is a tendency to shift towards formal practices as company grows.

9. Recommendations

Talent management is receiving increasing amount of interest. It has been proven that it is beneficial for the bottom line of companies. Therefore, SMEs should pay more consideration towards it. In the increasingly knowledge-based markets with growing competition, human resources are one of the main source of company's sustainable competitive advantage.

There seems to be a barrier that managers have to go through when developing their HRM strategies. It seems that the smaller the company, the less knowledge there is about the subject and the more control owners are forcing upon the business. Since each business' practices are very individualised according to the values, attitudes and the long or short term focus of the owner, it seems that it is not only the size of the company, but the manager himself is responsible for poor (or good) HRM.

Therefore, in many cases problem lies with the manager. I would suggest managers with little or no management experience to take training courses. The more knowledge and awareness they get, the better they will realise the benefits of talent management. Talent management brings a positive impact on the future of the business and the motivation of employees. Thus in the end both the employer and the employees are happy.

Focusing on long term is also an issue. Managers have to identify their long term human resource needs and try to develop employees accordingly. It is true that due to higher uncertainty that SMEs are facing in the market their understanding of long term can be much different than LSEs. For a smaller company long term could be two to three years, whereas larger companies can see it as over 5-10 years. But whichever understanding of time they have, it is still important to plan ahead (whether it is 2 years or 10). Attraction

and retention is the hardest for SMEs and it has to be clear that the biggest impact on the business comes from what you do with your current talent. Human resource strategies have to be incorporated to the whole business strategy and serve as a cornerstone for creation of sustainable competitive advantage. Maximum utilization of the workforce is to be the main focus. SMEs can learn from large organisations on strategy development and long term orientation.

Also, there are lessons that large companies can learn from management in SMEs. Ability to tailor to each employee case-by-case enables them to clearly identify the needs for development and retention of employees. Large companies are always trying to “think global, but act local” and this could be the way to start. Managers and HR department has to be involved in company strategies together. Stronger bonds and involvement with employees have to be formed, not only by the middle (and top) managers, but also by HR managers. Same as for SMEs, there is a need for integrated talent management. HR managers have to fully understand the type of job each employee is doing and what is going on in the company, not only on the short term, but also in the long run. This enables the manager to identify employee motivation level and needs better.

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11. Appendices

11.1 Appendix 1: Summary of de Kok, J. (2003) “Human Resource

Management within Small and Medium-Sized Enterprises”

The importance of human resources has received much attention in recent years. At a macro level, endogenous growth theories suggest that the accumulation of human capital constitutes the main engine of macro-economic growth (Lucas, 1988, 1993; Romer, 1987, 1996; Mankiw et al., 1992). At a micro level, resource-based theory points to the human capital of employees as a major source for sustained competitive advantage for individual firms (Ferligoj et al., 1997; Koch and McGrath, 1996; Wright et al., 1994). Due to the increasing importance of human capital, which to a large extent is related to developments in information and communication technologies, current western economies are described as knowledge-based economies.

The increased importance of human capital is apparent at both the demand and the supply side of the labour market. However, an adequate supply of and demand for highly qualified labour is in itself not enough to guarantee economic progress; for each individual firm, supply of and demand for labour and human capital must be matched. Companies in the knowledge-based economy are challenged to meet their demand for highly trained employees in labour markets characterized by a shortage of qualified labour (Audretsch and Thurik, 2000, 2001). Human resources are becoming more important, and therefore also the management of these resources.

At the same time, the knowledge-based economy is characterized by an increasing share of small and medium-sized enterprises or SMEs (Audretsch and Thurik, 2000; Audretsch et al., 2002). Generally speaking, small firms pay less attention to human resource management or HRM than their larger counterparts do (Barron et al., 1987; Hornsby and Kuratko, 1990). Thus, while on the one hand the rise of the knowledge-based economy increases the importance of human resource management, the increase of the SME sector, which employees roughly half of all employees, is associated with a decrease of HRM practices.

Does the combination of these developments pose a threat to the success of knowledge-based economies? Our current understanding of HRM practices within SMEs is as yet insufficient to provide an answer to this question. As Heneman et al. (2000) conclude after a literature review of more than 400 articles, the available literature “appears to be rich in prescriptions, limited in sound descriptive surveys, and sparse in analytical research”. Especially quantitative studies, in which hypotheses on HRM within small firms are specified and tested empirically, are lacking (Heneman et al., 2000, page 15).

The aim of this PhD thesis is to increase our understanding of HRM practices within SMEs. On the one hand, we shall investigate determinants of HRM practices. Small and medium-sized firms differ from each other in their application of HRM practices, and we shall examine how these differences may be explained by various organizational characteristics. This is examined both for HRM practices in general, and for a specific field of HRM practices (precautionary actions to reduce absenteeism). On the other hand, the impact of HRM practices will be considered. Again, both the impact of HRM practices in general and the impact of specific HRM practices (firm-provided training) is examined.

To this end, five studies are presented in this thesis, which share a similar approach and methodology. First of all, they all focus on HRM practices rather than policies. Next, they assume bounded rational behaviour by the manager or business owner. The concept of bounded rationality is an important aspect of transaction cost theory, which plays an important role in three of the five studies. Finally, the studies have a quantitative orientation in common. In the first four studies, hypotheses are derived that specify relationships between explanatory variables and dependent variables. These hypotheses are tested using available data. The fifth study is based on a simulation model on labour flows within individual firms. The model has been calibrated using empirical information, and simulation results resemble empirically observed labour flows. This simulation model combines elements from various theoretical perspectives, and includes several HRM practices. In an indirect way, these HRM practices are part of the explanatory variables that explain firm size, which is the dependent variable in this study.

The next chapter presents an overview of the current knowledge on HRM within SMEs. The chapter starts with a literature review on the fields of HRM and SMEs, which is subsequently used to derive the theoretical framework, objective and research questions for this thesis. This is followed by the main results from the studies that have been performed. Consequently, chapter two is a combination of an introduction into and a summary of this thesis (a summary chapter is therefore not included, except for the summary in Dutch). Chapters three to five present the results of the underlying studies on determinants of HRM practices, while chapters six and seven contain two studies on the impact of HRM practices.

Chapters three to seven are presented in such a way that they can be read independently of each other. Thus, readers who are specifically interested in one of these studies can directly turn their attention to the chapter of their interest (although it is recommended to read the literature review included in chapter two first). These studies have also been published separately: chapters three to seven are based on De Kok and Uhlaner (2001), De Kok et al. (2003), De Kok (2001), De Kok (2002) and Den Butter et al. (2001).

11.2 Appendix 2: Summary of De Kok, J. & Koch, C. (1999) “A Human-Resource-Based Theory of the Small Firm”

This report presents a conceptual model as to how personnel management is established within small enterprises.

The model presented in this research report is based on the human-resource-based theory of the firm (Paauwe, 1998), which explains how human resource management policies come into being. On the one hand, this theory emphasises the importance of various stakeholders who form the *dominant coalition* of an organisation. Values and attitudes of the members of this coalition determine the long-term objectives and influence the way personnel management is effected. On the other hand, the theory recognises that the available *room to manoeuvre* for this coalition is limited by product, organisational and social dimensions. In summary: the space available to the dominant coalition to manoeuvre leads to specific approaches to HRM, the outcomes of which to a greater or lesser extent satisfy specific objectives.

In our study we have extended the human-resource-based theory of the firm to include small enterprises, by introducing some stylised facts concerning small enterprises: the dominant position of the employer, the lack of ‘classical’ management styles and a low degree of specialisation within the production process. We argue that the employer is often the only stakeholder in the dominant coalition. As a result, his/her attitudes have an important impact on the room to manoeuvre. Despite the heterogeneity within the population of small enterprises, it is possible to distinguish some general attitudes shared by most employers: they like to participate in the production process rather than carry out management tasks, and they want to keep full control. Besides the dominant position of the employer, the room to manoeuvre is limited by external factors or influencing dimensions. We mention the fact that small enterprises are less specialised compared to their larger counterparts, and discuss limitations imposed by the process approach to strategy formulation.

These typical SME-features also manifest themselves in the objectives of small enterprises: many employers rate continuity, keeping full control and a good working climate among their most important long-term objectives. The strategy of a firm is determined within the dominant coalition. This includes the (main characteristics of the) personnel management. Due to differences in the dominant coalition (and its room to manoeuvre), personnel management will also differ

between firms: each firm has its own unique approach to HRM. Looked at from the perspective of small enterprises, this raises the following question: if small firms have certain features in common regarding their dominant coalition, do they also share general characteristics of personnel management? And if so, how are these general characteristics related to their long-term objectives?

There is very little known empirical research on this subject. In order to gain new insights in the unique approaches to HRM, we conducted an empirical investigation among 18 small Dutch enterprises. First of all, the results of this investigation were used to examine hypotheses about the relations between the room to manoeuvre and personnel management. The results of the survey were in agreement with the hypotheses. We found, for instance, that most small enterprises do not pursue a growth strategy, as we expected – based on their objective to keep full control.

Next, the investigation was used to elaborate our understanding of the unique SME approaches to HRM. We discussed the fact that small enterprises have a number of general characteristics that determine their room to manoeuvre. In theory, this could result in some general principles personnel management that apply to many small enterprises. Our investigation suggests that this is indeed the case. Despite the uniqueness of enterprises, three general principles of personnel management measures for small enterprises have emerged: a strong accent on team spirit, informal working procedure and firm co-ordination by the employer. These characteristics prove to be strongly related to the long-term objectives of the employer: continuity, creating a good working climate and keeping full control. Future research is needed to confirm these findings.

The existing normative models on HRM are often based on a large-firm blueprint and take the classical approach of strategy formulation. We conclude that this approach is not relevant for small enterprises: personnel policies of small enterprises cannot be judged without paying attention to the characteristics of small firms.

11.3 Appendix 3: Summary of De Kok, J. & den Hertog, D. (2006) “Is Human Resource Management Profitable for Small Firms?”

Introduction

A substantial body of HRM research has investigated the relationship between HRM and organizational performance. Recent work tends to study the effects of integrated 'systems' or 'configurations' of HRM practices on different indicators of firm performance. A high performance work system (HPWS) can be defined as a set of distinct but interrelated HRM practices that together select, develop, retain, and motivate a workforce

- that has superior knowledge, skills and abilities;
- that applies their abilities in their work-related activities;
- whose work-related activities result in these firms achieving superior intermediate indicators of firm performance (i.e., indicators over which the workforce has direct control) and sustainable competitive advantage.

Overall, the results of the work on HPWS and performance suggest substantial benefits from effectively managing human resources. Nevertheless, many questions remain unanswered. In particular: do these findings hold for all organizations, irrespective of their size? In this study, we address this issue and examine whether the relationship between a high performance work system and different indicators of firm performance also holds in a small business context.

Research framework

In general, smaller firms are less likely to use formalized HRM practices than larger firms. Nevertheless, it does seem intuitively likely that HRM will also matter in small firms, even though the specific practices that are relevant and the specific benefits yielded (e.g. performance, innovativeness, growth) may differ. However, only few studies so far have focused on HPWS and their effectiveness in small and medium-sized enterprises (SMEs). In this study, we examine the relationship of HPWS with different firm performance indicators (firm profit, labour productivity and labour turnover) in a sample of Dutch SMEs. We expect that the application of a high performance work system will be positively related with the level of labour productivity and firm profit, and negatively with labour turnover and sickness absence.

We furthermore expect that these relationships may be moderated by the innovativeness, leadership style and size of the firm. In today's competitive marketplace, innovativeness may be required to ensure firm performance. Merely having an adequate level of productivity is not sufficient for SMEs: they must also ensure sufficient productivity growth. Thus, SMEs need to continuously renew and improve their product offerings, services and work processes to secure long-term survival, profitability, and growth. Firm performance in SMEs may also be influenced by their top managers' leadership style. Previous research suggests that transformational leadership may improve performance and innovativeness. Managers exhibit transformational leadership if they have vision, stimulate employees intellectually and use individualized consideration and mentoring to help them develop their full potential. Such leadership goes beyond the cost-benefit exchange of transactional leadership by motivating and inspiring subordinates to perform beyond expectations. In this study, we explore how HPWS, innovative-

ness and leadership style interact with each other and with firm size, and to which extent these interactions affect firm performance

Research methodology

To examine these expectations, we use the EIM policy panel. This is a panel of Dutch SMEs (stratified by size and sector) who participate in telephonic 15-minute interviews on different topics several times a year. We use data from several consecutive interviews during which information was obtained on performance indicators, HRM practices, leadership style of the entrepreneur and several characteristics of the enterprise and the entrepreneur. We selected all firms from this panel that met the following criteria: the work force must consist of more than 5 people (including the entrepreneur) and the owner or general manager in charge must have answered the questions. This resulted in a working sample of 909 enterprises (with the largest firm employing 175 people).

Our measure for the presence of HPWS is based on a previous study amongst SMEs from the US. The HPWS indicator that is used in this US study includes items on extensiveness of staffing, performance based pay, pay level, job rotation, training, participation and self-directed work teams. Due to differences in institutional setting and sampling, this indicator needed some modifications. In particular, in testing the questionnaire we found that gathering information on self-directed teams in Dutch SMEs was not possible as this concept is not yet known among or used in Dutch SMEs. We therefore had to drop items on self-directed teams. Thus, our HPWS indicator combines 6 rather than 7 HRM practice areas. A few smaller differences also exist.

For 3 of the 6 components of the HPWS indicator, information is missing for over 50 organizations. For example, 60 organizations hadn't recruited any new employees in the past three years, and hence couldn't answer questions on extensiveness of staffing practices. As a result, any analysis on the full HPWS indicator is limited to organizations that have recruited employees in the last three years. This is most likely not a random selection of SMEs. In particular, we find this to be related to firm size (smaller firms are less likely to have recruited new employees recently). As a result, the full HPWS indicator can only be defined for 525 organizations. We limit this problem by defining the HPWS indicator in an alternative way: not as the average score over all 6 HPWS components, but as the average score of all available HPWS components, provided that information is available for at least 5 components. This increases the number of valid observations from 525 to 828. For each HPWS component the correlation with both HPWS indicators is very similar, suggesting that the alternative indicator is acceptable for use in subsequent analyses.

We also measure leadership. Ideally, employees should rate leadership. Here however, we were only able to gather self-ratings of leader behaviour. Various performance measures are included in this study: labour turnover, labour productivity (per full-time equivalent), profit (per full-time equivalent), and recent innovativeness. We also include controls such as firm size, educational level of the entrepreneur and sector.

Results and Conclusions

The general picture that emerges from previous studies is that firm size is positively related to the adoption of many HR instruments. Smaller firms are less likely to use formal HRM practices than larger firms are. This not only applies at the level of individual HR instruments, but also at the level of configurations of HR instruments. The findings of this study confirm that this also applies to the set of HR instruments that define a high performance workplace system. Larger firms have on average a higher score on our HPWS index than smaller firms do.

In addition, we find that firms where the entrepreneur's leadership style is more transformational also tend to have a higher score on our HPWS index. Furthermore, the score on the HPWS index is also positively related to labour productivity and profit per fte. Contrary to expectations, transformational leadership is not related to labour productivity or profit. To further examine the relationships between these variables, we ran various multivariate regression analyses.

Our hypotheses regarding labour turnover are partially supported. The probability that an organization has a high labour turnover rate does not depend on HPWS but rather on leadership style: transactional leadership is associated with high turnover levels, while transformational leadership is associated with low turnover levels. These two main effects are the only significant effects of leadership style that we found in our study.

Regarding innovation, the results show that larger firms and firms with a highly educated entrepreneur were more likely to have innovated more in the recent past than other firms. Also, some sector differences exist. As expected, we also find a significant positive effect of the HPWS indicator. Increased attention for HPWS in SMEs is associated with an increased likeliness of firm innovativeness.

Labour productivity varies between sectors of industry and tends to increase with the educational level of the entrepreneur. In line with previous studies amongst larger firms, we find that also for small firms an increased attention for HPWS improves labour productivity. This positive effect of HPWS on labour productivity is not due to an indirect effect through innovation or labour turnover. Also, it is independent of firm size.

For profit, we find a positive effect of labour productivity and a negative effect of high rates of sickness absence. We find no direct main effects of HPWS and leadership styles, but we do find a positive interaction effect between HPWS and firm size. Thus, HPWS has more impact on the profitability of larger firms than of smaller firms. Although the results suggest that labour productivity mediates the relationship between a high performance work system and profits, further analysis shows that this is not the case. While the indirect effect of a high performance work system (through its effect on labour productivity) is independent of firm size, the direct effect is strongly related to firm size.

Finally, we find no relationship between HPWS and sickness absence. This may be due to our focus on SMEs. Generally speaking, sickness absence may be due to a lack of ability or a lack of motivation to attend to work. HPWS may reduce sickness absence levels, to the extent that it increases the motivation of employees to attend to work. However, in the case of small firms it is likely that sickness absence is mainly the result of a lack of ability to attend rather than a lack of motivation to attend.